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TAGS: ECON EINV RS

SUBJECT: INITIAL SSL CASES REVEAL LITTLE; SKEPTICISM
REMAINS

REF: A. MOSCOW 804
 1B. MOSCOW 821
 1C. MOSCOW 893

Classified By: Economic Minister-Counselor Eric T. Schultz, Reasons 1.4
(b,d)

11. (C) Summary. Almost six months after enacting the Strategic Sectors Law (SSL), the GOR has permitted the first two foreign investments under the legislation. Both of the deals had been pre-approved by Prime Minister Putin earlier this year and are thought to have been chosen to go first in order to increase investor confidence in the process. Observers with whom we discussed the law remain ambivalent about its effects. The more cynical describe it as a mechanism for GOR officials to collect additional "royalties," while others see it as a potential step forward in adding clarity and transparency to investing in strategic sectors. End summary.

Investment Climate: Just Like the U.S.?

12. (C) One of Putin's final acts as President was overseeing the enactment of the SSL and designating the Federal Anti-Monopoly Service (FAS) as the agency authorized to vet potential foreign investors (reftels). It was not, however, until four months after promulgation of the legislation that the responsible division of the FAS received the first applications from foreign investors interested in gaining stakes in Russia's "strategic sectors".

13. (C) In a September meeting, head of the foreign investment division of FAS Svetlana Levchenko told us that while initial applicants were few, the division was "ready for business" and hopeful of creating an open and liberal investment climate, such as exists in the U.S.. She underscored that FAS' role was not intended to be obstructionist but that, like the Committee on Foreign Investment in the U.S. (CFIUS), it was entrusted with protecting national security interests.

14. (C) In discussing the vetting process, FAS Deputy Head Andrei Tsyganov assured us that investors who were refused permission to invest would be informed as to why. He emphasized that FAS intended the application process to be non-confrontational and he expressed the hope that investors would feel comfortable in engaging in a give and take with the agency as their documents were examined.

First Applicants: Pre-Approved by Putin

¶ 15. (U) News reports identified the first two applicants as DeBeers (a Canadian subsidiary) and Alenia Aeronautica (Italian). FAS' foreign investment division also returned the application materials to a third unidentified applicant for additional documentation and reportedly an additional eight have had their documents accepted by the FAS, but no decisions on their plans have been made as yet by the Commission.

¶ 16. (SBU) The DeBeers deal dates back to 1996 and represents the settlement of a dispute with LUKoil over rights to development of a diamond mine discovered at the time. It would allocate a 49.99 percent interest to DeBeers, with LUKoil controlling the remainder. Putin is said to have approved the agreement at a Kremlin meeting with the principals in April 2008. Similarly, Alenia Aeronautica's transaction (which gives Alenia a blocking 25 percent plus one share) with Sukhoi Civil Aircraft to build the Sukhoi Superjet-100 has been in the works since 2005; Putin approved it by Presidential decree in January 2008. Some speculate that DeBeers and Alenia were encouraged to "go first" in an effort to increase foreign investor confidence in the SSL process.

Experts: Putin's Percent?

¶ 17. (C) DLA Piper partner, Jon Sokolow (protect), a U.S.

lawyer who has been involved in Russia's strategic sectors for the past decade and who has many clients that will need to have investments approved by the Commission, told us he was confident the new system was not designed to prevent foreign investment. However, he recalled "Misha 2 percent" (a nickname referring to the "commission" percentage that Mikhail "Misha" Kasyanov allegedly collected on major business deals during his tenure in the Russian Government) and predicted that Putin and other insiders would use the Commission process to collect bribes in return for approval.

¶ 18. (C) Another U.S. lawyer, Jonathan Hines (protect), a partner at Dewey and LeBoeuf with substantial experience with foreign investors in strategic areas was genuinely hopeful that the legislation represented a step forward for Russia's investment climate. While reluctant to classify the implementation of the SSL as a "positive", he thought it was "neutral" at worst. Although he conceded that he could not imagine approaching FAS for an investment approval without having received some sort of "pre-approval" from GOR interests, he flatly rejected the "Misha 2 percent" analogy.

¶ 19. (C) Petroleum Advisory Forum's Vladimir Konovalov told us he was inclined to judge the SSL process as "window dressing for the West." His sense was that the GOR wanted to use the SSL process to dampen the criticism that Russia has faced about the incoherence of its treatment of foreign investors in sensitive areas. In that regard, he predicted that natural resources investors, whose investments were dictated by geography, were unlikely to be dissuaded by the SSL process, no matter how opaque.

Comment

¶ 10. (C) The first two SSL approvals provided neither a useful template for subsequent investors, nor did they enlightened anyone as to how the FAS or the Commission understands its role in protecting Russian national security interests. While the process has some supporters in the foreign investment community, skepticism over GOR intentions abounds. Natural resources investors may have little choice but to

put up with the process, but the SSL also covers
"innovation" sectors and these potential investors will have
little reason to choose Russia over other, less restrictive,
investment possibilities.

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